IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No. 70-28

UNITED STATES OF AMERICA,
Petitioner,

versus

EDNA GENERES, Wife of, and ALLEN H. GENERES,
Respondents.

On Writ of Certiorari To the United States
Court of Appeals For the Fifth Circuit

PETITION FOR REHEARING

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AUTHORITIES

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Respondents present their petition for a rehearing of the above entitled cause, and, in support thereof, respectfully show that:

GROUNDS FOR REHEARING

1. The basic facts of the case are fully set forth in Part I of the majority opinion, rendered herein on February 23, 1972. This is an important business-versus-non-business bad-debt income tax case, with far-reaching consequences to taxpayers throughout the country.

2. Internal Revenue Code Section 166 allows business bad debts to be fully deducted, but allows non-business bad debts to be treated only as losses from the sale of short-term capital assets. Section 166 (d)(2)(A), stating the standard for determining business bad debts, says that they must be created or acquired "*in connection with* a trade or business of the taxpayer." (emphasis added). Interpreting this statutory language, the Regulations prescribed a proximate relation test to find the required "connection."

3. The Supreme Court's decision in *Whipple v. Commissioner*, 373 U.S. 193, 201 (1963) specifically approved the standard of proximate relation for determining business bad debts, but it did not set up a standard for determining the proximate relationship.

4. To make the determination of proximate relationship, the courts must look to the taxpayer's motives in creating the debt, and the instant case involves the necessity of determining which motivational standard, *dominant* motivation or *significant* motivation, to apply to find such "proximate" relationship. The majority opinion of February 23, 1972, adopts the dominant motivation test.

5. Respondent respectfully submits that the majority opinion is in error in several respects, and should be reconsidered, particularly with reference to the adoption of the dominant motivation

standard, but also because of the denial of a new trial to taxpayers.

6. The majority opinion never discusses the actual language of the statute, nor the specific change in such language that was made in 1954 (as traced in Respondent's original brief herein). The opinion appears to be based on policy and not on strict construction of the statute itself. Under the 1939 Code, a business debt was defined as "a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business." However, the 1954 Code broadens this definition to include a debt "created or acquired in connection with a trade or business of the taxpayer . . ." Obviously, this additional definition requires a less direct relationship with a taxpayer's trade or business. But the majority opinion nowhere discusses the words "created or acquired," nor does it even quote much less interpret the extremely important words added in 1954: *"in connection with."*

7. It would seem that if Congress had intended the words "in connection with," as used in Section 166, to mean primary motivation, Congress would have so stated. See: *Malat v. Riddell,* 383 U.S. 569 (1966), in which this Honorable Court construed Section 1221(1) of the Internal Revenue Code, which excluded from the definition of a capital asset that property held *"primarily* for sale to customers in the ordinary course of his trade or business." This Court held that "primarily" meant "principally" or "of first importance." In numerous Internal

Revenue Code sections Congress has used the term "principally" to indicate that the application of these sections requires the existence of a primary or dominant purpose. See, e.g. I.R.C. Sections 269 (a), 357(b)(1), 355(a)(1)(B); see also Sections 1221 (1) and 1231(b)(1)(B). The omission of such an unequivocal term in Section 166 would appear to indicate an intent to require only a substantial or significant connection with a taxpayer's trade or business.

8. The primary or dominant motivation test discriminates against the taxpayer who may have had several motives for incurring an obligation, and the dominant motivation test would disallow a deduction even though the taxpayer would not have had the bad debt had it not been for his business.

9. The significant motivation test is not a "free-wheeling" approach to bad debts: it would allow a taxpayer to deduct as a business bad debt any debt that was significantly motivated by his business. This would not sanction baseless deductions. When the employment motive is not significant, clearly the bad debt is non-business.

10. In terms of policy, Congress has manifested a trend toward aiding small businesses. The addition of Internal Revenue Code Section 1244 and the Subchapter S provisions of the Small Business Act of 1958 indicate a congressional policy of encouraging the development of small businesses, even at the cost of creating disparity in the treatment

of investment activities. These two cited sections provide tax relief to taxpayers who, as in the instant case, are shareholders in closely-held corporations. Under certain circumstances Section 1244 allows ordinary loss treatment on investments in the stock of small business corporations.

11. The majority opinion characterizes the Regulations' use of the term "proximate" as "unfortunate." Yet it was the Commissioner, and not Congress or the taxpayer here, who chose to use such verbiage. Analogies to the law of torts should have been expected, since the use of "proximate" originated in the tort law as a means of delineating between remote causes and those causes upon which liability could be sufficiently based: Prosser, *Torts*, Sec. 49 (3rd Ed. 1964). Since only remote causes are excluded, when two concurring causes exist, both can be proximate even though one may have been more dominant in bringing about the final result; either cause need only make a significant contribution to the end result to be a basis of liability.

12. In view of (1) the accepted meaning of "proximately related" as excluding remote causes and including substantial but not necessarily dominant or primary causes, and (2) the legislative history and change of language in Section 166, and (3) the congressional policy of aiding small businesses, and (4) the omission of the word "primarily" in section 166(d), Respondent respectfully submits that when the employment motive is signifi-

cant, the debt should be classified as a business bad debt. If, as a matter of policy or protection of the public fisc, any other result is desired, recourse should be had to Congress and not to the courts.

13. Respondent respectfully urges that even if this Court adheres to the dominant motivation test, nonetheless the taxpayers should, in fairness, have their day in court on the new-and-now-decided test of dominant motivation. By a vote of 4-3, that day in court is now denied them. The majority opinion states that "reasonable minds could not ascribe, on this record, a dominant motivation directed to the preservation of the taxpayer's salary," and remands the case with direction that judgment be entered for the United States.

14. Taxpayer is at a loss to understand how four justices can say *no reasonable man* could find such motivation, when two of their brethren on the bench believe that reasonable men *might* be able to find such motivation. That fact alone would indicate that reasonable men can disagree. Further, the remand with instructions to enter judgment for the government deprives the taxpayer of his day in court at least to *attempt* to show dominant motivation. At the time this case was tried, in 1967, the only jurisprudence on the issue was *Weddle v. Commissioner,* 325 F. 2d 849 (2 Cir. 1963), in which the majority upheld the significant motivation test. Mr. Generes' case was tried and present-

ed under that state of the law; he has not had a day in court on the dominant motivation test.

15. Twelve jurors believed, on *this* record, that there was a significant employment motivation, and the trial judge did not consider such finding unreasonable. Two distinguished judges of the United States Fifth Circuit Court of Appeals believed, on *this* record, that there was a significant motivation. It appears anomalous for This Honorable Court now to say that there is such an enormous distinction between significant and dominant motivations, that no reasonable man could find dominant motivation here when so many reasonable people found significant motivation.

16. Taxpayer should not be denied the opportunity even to present any evidence on the basis of the *new* guidelines to twelve presumably reasonable people. The majority opinion discusses the pre-tax and after-tax values of the investment and the salary, as to which Mr. Generes is now deprived of the right to testify further. The majority opinion states that the "actual value" of the original investment by 1962 "we do not know," and yet Mr. Generes is denied any right to establish that value. The majority discusses his "personal interest in the integrity of the corporation as a source of living for his son-in-law and as an investment for his son and his other son-in-law," matters which were never discussed at the trial in 1967 and which Mr. Generes is now forever precluded from discussing. Mr. Generes has not submitted his case with the

new guidelines and the new test to a jury. If twelve jurors, a district judge and at least two members of the Court of Appeals believed that such employment motivation as was shown here was *significant*, surely in fairness and good conscience this taxpayer should at least be afforded the opportunity to attempt to meet the dominant motivation test. He may not be able to meet his new burden, but with all of the pre-tax and post-tax factors being admittedly conjecture by this Court, surely Mr. Generes should have his day in court and be given the opportunity to meet it.

CONCLUSION

For the foregoing reasons, it is respectfully urged that this petition for a rehearing be granted, and that, upon further consideration the judgment of the Court of Appeals be affirmed, or in the alternative, that if the judgment of the Court of Appeals is reversed, then the case be remanded to the District Court for a new trial.

Respectfully submitted,

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of
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CERTIFICATE OF COUNSEL

I, Max Nathan, Jr., counsel for the above-named respondents, do hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay.

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Counsel for Respondents

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PROOF OF SERVICE

I, Max Nathan, Jr., one of the attorneys for Edna Generes, Wife of and Allen H. Generes, respondents herein, and a member of the Bar of the Supreme Court of the United States, hereby certify that, on the ____ day of March, 1972, I served five (5) copies of the foregoing Petition for Rehearing on the United States by mailing such copies in a duly addressed envelope, with air mail postage prepaid, to the Solicitor General, Department of Justice, Washington, D.C. 20530.

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